Docket No: 98-0252/
98-0335/00-0764/
Consol.
Bench Date: 11/19/01
Deadline: N/A

M E M O R A N D U M

TO:	The Commission
FROM:	Eve Moran and Phillip Casey, Administrative Law Judges
DATE:	November 16, 2001
SUBJECT:	Illinois Bell Telephone Company Application for review of alternative regulation plan. Illinois Bell Telephone Company Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates. Citizens Utility Board and The People of the State of Illinois -vs- Illinois Bell Telephone Company Verified Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief.
RECOMMENDATION:	Approve continuation of the Alternative Regulatory Plan with modification.

Background

On May 22, 2001, the Administrative Law Judges ("ALJs") issued a Proposed Order in this proceeding ("HEPO"). Thereafter, Briefs on Exceptions and Reply Briefs to exceptions were filed by the parties on June 14, 2001 and June 25, 2001 respectively.

Shortly after the Exceptions briefing stage was completed, i.e., on June 30, 2001, Public Act 92-0022 went into effect. The ALJ's reasoned that the legislative amendments to the Public Utilities Act i.e., the law currently in force, had to be considered in the instant matter and, thus, directed the parties to file an additional round of briefs regarding the impact of the new law on the issues in the case. (See, ALJ Ruling, July 5, 2001). Such briefs were filed on July 25 and August 14, 2001.

Further, a status hearing was held on July 24, 2001, for the purpose of determining whether, in light of the new law, parties desired to re-open the record. Only AI expressed an interest in so doing, and only on a very narrow issue. Ultimately, AI's request was denied and it did not seek review of this ruling.

Having considered both the exceptions briefs and the briefs on the new law (and no new evidence), the ALJ issued a Post-Exceptions Proposed Order ("PEPO - Version I") to be served on the parties in this instance. Under direction of the Commission, the ALJs issued a ruling which gave parties the opportunity to address, in a "second" exceptions brief, any of the interpretations and/or applications of the new law set out in this initial PEPO.

The last of these Exceptions arguments and positions of the parties (Staff, AI, AT&T, and the GCI/City) are reflected in the Final PEPO attached hereto.

THE ISSUES

Here and now, we summarize the major issues addressed in the Final Post-Exceptions Proposed Order (hereinafter the "PEPO"), for this proceeding:

- **The Plan Review (Parts II and III).**

Initially, the PEPO considers the Commission's goals, directions for review, and the statutory requirements of Section 506.1 together with the evidence and arguments of the parties thereon. This largely historical assessment concludes with the determination that the Plan has worked well in most particulars, that it might benefit from the modifications proposed, and that alternative regulation remains more appropriate than going back to rate of return regulation.

(Differences between the HEPO and the Final PEPO are relatively minor).

- **Rate Re-Balancing (Part IV).**

AI has withdrawn its rate rebalancing proposal. Staff and Intervenors suggest that the Commission make a finding as to whether the Company's proposed LFAM model is deficient, while AI urges the Commission to adopt its LFAM model or alternatively direct Staff to work with the Company to address and resolve specific concerns with AI's model. The PEPO concludes that it is unnecessary for the Commission to address and resolve the contested issues where the party initiating the matter withdraws its request.

- **Going Forward (Part V).**

A. Formula

The PEPO reviews the existing components of the Price Cap formula as ordered in the original Alternative Regulation Order. The PEPO then considers modifications to the PCI as proposed by the parties.

1. Measure of Inflation

One component of the PCI is the Inflation factor, which is derived by using GDPPI. The GDPPI is used to measure the annual economy wide inflationary change that has occurred in a given time period. GDPPI is published by the Bureau of Economic Analysis, U.S. Department of Commerce ("BEA"). At the time of the Commission's original Alternative Regulation Order, a fixed weight version of GDPPI was the accepted and published output measure of inflation for the economy. Since the entry of the Order, a "chain weighted" GDPPI has replaced the fixed weight GDPPI as the most commonly used inflation measure in the economy. The parties agree that it is more proper to use the chained weighted GDPPI in the future as the inflation index. As such, the use of a chain weighted GDPPI has been substituted for the fixed-weight version in the price index on a going forward basis.

2. X Factor

Under the Plan, the "X" Factor in the price cap formula consisted of three elements: productivity differential, input price differential, and consumer dividend. The productivity differential measures the difference between telecommunications total factor productivity gains and overall economy total factor productivity gains. Under the original Plan, the productivity differential was set at 1.3%, the input price differential was set at 2.0% and the consumer dividend was set at 1.0%. (Order at 38.)

Under the original Plan the productivity and input price differentials were based upon AI's productivity and input price performance versus the economy as a whole, as opposed to industry productivity and input price data. Industry productivity and input price data was not yet available. Now that industry productivity and input price data is available, Staff proposes, and AI and City/GCI concur, that both productivity and input price differential be based on industry performance rather than AI specific data. The PEPO adopts Staff's proposal. Further, the PEPO finds that the deflated revenue approach to measure output is also appropriate for use herein. The deflated revenue approach is widely accepted, including its prior use by this Commission

(a). Productivity Differential & Input Price Differential

AI proposes a productivity differential and input differential of 3.3%, with no consumer dividend for an overall X factor of 3.3%. Staff recommends a productivity differential and input differential of 3.3% plus a consumer dividend. City, AG, County, and CUB, recommend an overall X factor of 6.5% which would in effect incorporate a productivity differential, input price differential, and a consumer dividend. GCI bases it's recommendation of a 6.5% X factor on the proposal made by SBC, Bell Atlantic, Bell South, and GTE in the "CALLS" Proposal. The PEPO concludes that 3.3% productivity differential and input differential should be used on a going forward basis.

(b) Consumer Dividend

Staff supports maintaining a 1% Consumer dividend in the Price Cap Formula. AI urges the Commission not to extend a consumer dividend for another term of the Plan. Staff contends that an inclusion of a consumer dividend fulfills the requirement under Section 13-506.1 (b)(5) of the Act wherein an alternative regulation plan must specifically identify how ratepayers will benefit from efficiency gains, costs savings resulting from regulatory change and improvements in productivity due to technological change. City/GCI recommend that a consumer dividend be included in the PCI formula should the Commission rejects its suggested X factor. The PEPO finds that a 1% consumer dividend continue to be apart of the X factor. As such the total X factor equals 4.3% on a going forward basis.

3. (Z) Factor

The Z factor accounts for any impact associated with changes made to the Federal Communications Commission's ("FCC") rules, and/or with some other change which is quantifiable and outside AI's control, and has not been picked up in the economy wide inflation factor. Exogenous factor treatment should be allowed only for costs: 1) which are truly outside the Company's control; 2) which can not be picked-up on in the economy-wide inflation factor, to avoid double-counting; 3) which are verifiable and quantifiable, to ensure that the effect of the exogenous event can be accurately determined without protracted, controversial regulatory involvement; and 4) the changes must exceed $3 million.

AI proposes that the Z factor continue to be a component of the price cap index mechanism and that on a going forward basis, the Commission expressly recognize the exogenous treatment of Commission mandated rate reductions. Staff also proposes that the Z factor continue to be a component of the price cap index mechanism. Staff acknowledges that the Commission would want flexibility built into the price cap plan to deal with issues that cannot be satisfactorily dealt with elsewhere and the Z factor is a place where such discretion could be exercised. On a going forward basis, Staff proposes that AI must file for exogenous change treatment within 30 days of such revenue reduction with the specific rates it wishes to change. Staff would then review the proposed rate changes. Final rate changes necessary for revenue recovery would then be implemented no later than 60 days after the initial AI filing. Additionally, Staff proposes that the Commission reserve the ability to delay rate changes until the annual price cap filing, as well as deny revenue neutrality.

City/GCI contend that the exogenous change factor should remain unchanged.

AT&T opposes AI's request that the Commission expressly recognize that exogenous treatment of Commission mandated rate reductions are appropriate under the Plan. AT&T also opposes AI's proposal for immediate reductions.

The PEPO concludes that the Z factor continues to be a necessary component of the price cap index formula. The PEPO recognizes that the formula, without a Z factor cannot always reflect changing circumstances and balance competing interests fairly. The PEPO further allows that an exogenous event may also include a Commission mandated rate reduction. The Company still must satisfy the four criteria as set out in the original Order. In all other respects the Z factor remains as originally ordered, including the actual application of a Commission approved exogenous event on an annual basis.

4. Service Quality/Q Factor

The Act requires that an alternative regulation plan serve to maintain the quality and availability of telecommunications services. 210 ILCS 5/13-506.1 (b)(6). The PEPO agrees with Staff and GCI/City and concludes that the issue of service quality be addressed within the alternative regulation plan but outside the scope of the price cap index itself. As such, the Service Quality/Q Factor is eliminated from the PCI formula. A detailed examination of the issue of service quality can be found in the Section VII of the PEPO.

C. Pricing Flexibility

Under the original Plan, AI's pricing flexibility was limited to 2% over the percent change in the PCI and a rate cap was imposed on basic residential services for five years.

AI recommends that the Plan be modified on a going forward basis to allow the Company greater flexibility to increase prices. According to AI, pricing flexibility would "allow it to 1) adjust rates to the more competitive marketplace, and 2) allow it to move toward a more "economically efficient rate structure." Originally, AI made alternative proposal's based upon what the Commission would do with the Compnay's rate-re-balancing proposal. Given that AI withdrew its rate re-balancing proposal, AI requests authority to increase individual rates up to 10% per year with a cap of 30% during a 5-year period. Staff contends AI failed to explain why it needs any significant level of pricing flexibility for services for which it has no competitors. Staff recommends the continuation of a 2% pricing flexibility. City/GCI argue AI's pricing flexibility proposals be rejected.

The PEPO concludes that the current 2% pricing flexibility afforded to AI be maintained on a going forward basis.

D. **Proposed New Component/Merger Related Savings/M Factor**

City/GCI recommend the use of an M factor in the price cap formula. City/GCI propose that the M factor by initially established on the basis of the level of savings that Ameritech and SBC Boards of Directors had estimated when the "transfer ratio" value was set. Applying the 50% ratepayer allocation of savings that the Commission adopted in the Merger Order and Ameritech/SBC's estimated level of savings, would result in a M factor of 4.8.

AI specifically opposes City/GCI's proposal. The Company notes that making an adjustment now based on the same estimated data presented in Docket 98-0555 would be inconsistent with the plain terms of the original Order, which requires the adjustment be based on actual data. Since the Commission has already rejected City/GCI's methodology in Docket 98-0555, AI argues that there is no basis for adopting it here.

Staff took the position that actual merger savings will be known in time for the Company's annual filing on April 1, 2004, at which time a one-time adjustment to the price cap index should be made. The Company presented evidence indicating that the actual permanent level merger savings may be known sooner than that.

The Commission was clear in Docket 98-0555 that merger savings adjustments should not be based on estimates but rather actual merger related savings. The PEPO agrees with AI's recommendation and concludes that, on an interim basis, actual merger costs and savings continue to be examined and dealt with annually. This conclusion is consistent with the Commission's Order in Docket 01-0302. This approach leaves open the possibility of developing and implementing a permanent one-time adjustment to the regulatory treatment of merger costs and savings prior to the year 2004, if appropriate.

E. Baskets

Under the terms of the original Plan, non-competitive services were divided into four baskets. Originally each of the four baskets consisted of the following: 1) the Residential basket contained access and Band A, Band B, and Band C usage; 2) the Business basket consisted of business access, Band A through D usage, and certain discretionary services; 3) the Carrier basket consisted of switched access, special access, cellular access and other various carrier services; 4) the Other Services basket contained directory services, directory assistance, operator services, payphones, private lines, discretionary residential services and name and address service in Chicago. The baskets were structured to ensure that all customer classes benefited equally from price regulation, and, with respect to the splitting of residence services between the Residential and Other baskets, to facilitate the application of the five-year rate cap to basic network access lines and usage. (Order at 68-69.)

The four-basket system was maintained throughout the life of the Plan; however, the makeup within each basket has changed. As provided for within the Plan; AI was allowed to withdraw services from baskets by reclassifying them as competitive. Due to changes in legislation, the make-up of the basket structure as well as the contents of baskets require the Commission's review.

2. Proposed Modifications to the Basket Structure

(a) Consolidation of Baskets

On a going forward basis, AI proposes that all Plan services that remain under the Plan be consolidated into a single basket. Alternatively, AI proposes that all residential related services found in the Other basket and those in Residential be combined into one basket, eliminate the Business basket.

Staff objects to AI's single basket proposal because of its concern with customer class discrimination. Based upon the passage of HB 2900, Staff proposed legislatively mandated local service packages be placed in the Residential basket. Secondly, Staff recommends the elimination of the Business basket. Lastly, that access charges are non-competitive services Staff recommends that the Carrier basket should remain.

City/GCI argue for the creation of a separate "Statutory" basket for those flat rate service packages mandated under HB 2900. GCI expressed its concern with placing the mandated packages in the Residential services basket. In the event that the statutory packages are placed within a basket that contains an already existing service, GCI claim that AI could pursue a pricing strategy to raise the access rates so that consumers are driven to packages even if they do not suit their needs. Alternatively, GCI claim AI could increase prices for mandated package within a commingled basket and thus thwart the legislatures intent that packages would result in savings. As such, GCI conclude it is appropriate for the statutorily mandated packages to be place.

AT&T continues to call for the maintenance of a four-basket system. AT&T recommends that wholesale services be placed in the same basket as the corresponding retail service, or if the retail service has been declared competitive and been removed from the alternative regulation plan, in the same basket the corresponding retail service would be placed if it were still classified as noncompetitive.

(b) Voluntary Calling Plans

Staff proposes that the SimpliFive and Call Pak residential calling plans be transferred from the Other basket to the Residential basket. City/GCI concur in Staff's proposed treatment of these calling plans. AI opposes Staff and City/GCI's proposal to move SimpliFive and Call Pak calling plans from the Other basket and into the Residential basket. The PEPO concludes these two calling plans be transferred from the Other basket to the Residential Basket.

(c) Mandated Calling Plans

The three mandated plans contain services traditionally found in two baskets and some services that are outside of the Plan, as certain of those services are considered competitive services. Each of the three mandated packages bundle residence network access and usage, and in two instances with other services. Two of the three mandated packages contain services not traditionally found within the Residential basket.

The first of the listed statutorily mandated packages, the “Budget” package, offers residential access service and unlimited local calls (or usage), two essential features traditionally found in the Residential basket. By placing the Budget package within the Residential basket, savings to consumers in the future and residential subscribers as a class, will continue under alternative regulation. The PEPO concludes that the statutorily mandated Budget plan be placed within the Residential basket.

The remaining two statutorily mandated packages however, are more difficult to assign in that they also contain services traditionally found in the Other basket, as well as competitive services. Upon examination the two remaining statutorily mandated packages, the PEPO concludes that “Flat rate” and “Enhanced flat rate” should be assigned to a newly created “Packages” basket. It would be inappropriate to insert into the Residential basket, packages that contain services that are traditionally high margin services. The Residential basket contains the most basic inelastic services, primarily access and usage. Adding to the Residential basket, packages or services that have high margins could result in the manipulation or the increase of the costs of services presently found in the Residential basket. The Commission in its original Order sought to isolate those services found in the Residential basket from discretionary services to insure that price decreases required by the price index would inure to the benefit of low use, inelastic consumers. Certain services found in the Flat Rate package or Enhanced Flat Rate packages are higher margin services which could lead to manipulation as discussed above. Creation of the new basket will eliminate the mixing of services presently found in different baskets or competitive services with inelastic service currently found in the Residential basket.

Secondly, creation of a new basket for packages will provide an appropriate repository for certain calling packages that may be introduced in the future. The PEPO concludes that any packages that contain access, usage and other discretionary services should on a going forward basis, be placed in the new Packages basket.

Elimination of Certain Services from Baskets

AI recommends that 911 services, UNEs, wholesale and carrier access charges be excluded from the operation of the index, i.e. excluded from the basket structure.

The PEPO concludes that 911 services should continue to be excluded from the operation of the price cap index. With respect to UNEs, wholesale and carrier access charges, the PEPO concludes said items shall not be excluded from the operation of the index and shall be included within the basket structure. UNEs shall be made apart of the Carrier basket. Wholesale rates shall remain apart of the Carrier basket. Carrier Access Services shall remain in the Carrier basket.

(d) Reinitialization of APC & PCI

Staff and City/GCI recommend that these indices, which have declined over time, be reset to 100 on a going forward basis. According to Staff, reinitialization will have the effect of affording the Plan the maximum capacity to affect rate changes. AI opposes the reinitialization of the API/PCI indices. By reinitializing, AI argues, "headroom" is effectively eliminated. Headroom occurs when rates in particular baskets decline more than the index would have required. The PEPO concludes that the API/PCIs in the existing Plan should not be reinitialized on a going forward basis. However, the API for the Carrier basket must be adjusted as a result of adding UNE services to the basket. The calculation to adjust the API of the Carrier basket shall be similar in from to that proposed by AI for combining the API of the service baskets in this proceeding, with the existing API for UNE services being set at 100 and then weighted against the existing API and revenue for the basket.

F. Earnings Sharing

City/GCI propose that the Commission add an earnings sharing component to the Plan on a going-forward basis. City/GCI argue that AI's earnings have been excessive under the existing plan, and that ratepayers have received no benefit from these excess earnings.

AI opposes adoption of an earnings sharing provision. AI contends that earnings sharing brings with it all of the issues and baggage associated with rate of return regulation: debate over depreciation rates; extensive reporting and monitoring of AI's investments, rate base and profitability; prudence reviews; and continuing debates over the level of profits is earning and how much it should be allowed to keep. Thus, AI argues that earnings sharing does not break the link between AI's cost and rates.

Staff also opposes adoption of earnings sharing. According to Staff, earnings sharing represents double regulation.

The PEPO concludes an earnings sharing proposal should not be adopted. Earnings sharing was reviewed at length in 1994 at which time the Commission concluded that it was not an appropriate component of the Plan. Earnings sharing prevents the Commission from delinking AI's cost and rates and continues too many of the negative aspects of rate of return regulation. Earnings sharing compromises the regulatory objectives relative to this Plan and will not be adopted.

G. Monitoring and Reporting

Staff and City/GCI contends monitoring and reporting requirements must remain if the Commission is to extend AI's Alternative Regulation Plan. Without reporting and monitoring requirements, Staff argues the Commission, its Staff, and the other parties with a legitimate interest in whether AI is complying with its obligations under the plan would be unable to make an informed assessment. Even where information may be duplicative, they contend that there should be a single complete source of information regarding AI's performance under the Plan.

AI contends that the existing requirements could be streamlined. Specifically AI objects to the form of the Infrastructure report and states that it need not be retained if the infrastructure investment commitment is not retained.

The PEPO concludes that the reporting requirements associated with this Plan should be retained. The PEPO recognizes that the Commission, Staff and other parties have a legitimate interest in determining whether AI is complying with its obligations under the Act. The information supplied by AI through the monitoring and reporting requirements is a critical tool for determining whether AI is complying with the conditions of the Alternative Regulation Plan. The PEPO acknowledges that in certain limited instances, reporting requirements may be duplicative. However, there should be a single complete source of information regarding Ameritech's performance under the plan.

H. One-Time Credits or Refunds

Staff proposes two one-time credits or refunds be required as part of the Commission's final Order in this proceeding. Staff contends that a credit or refund is required to correct AI's use of an improper definition of irregular service installation. Staff objects to the inclusion of orders for vertical services in AI's reports relative to installation within five days, and contends that these reports should be limited to network access lines. Staff believes the Company has applied an inappropriate definition of "installation" performance for that measure.

Second, Staff argues that $7.4 million should be flowed back to customers to correct for the improper re-classification of certain residential services as competitive, a classification which AI voluntarily withdrew in February of this year.

AI opposed the refund proposals. With respect to Installation Within Five Days, AI contends that Staff's proposal is unreasonable because the Company has always reported its installation data including all new ("N"), transfer ("T") and change ("C") orders. The Company pointed out that in fact, it is the definition suggested by the language of a recent NARUC white paper on service quality measures. Further AI argues that this is the way AI reported the data upon which the current Plan benchmark is based.

AI also opposes a refund/credit associated with the reclassification of certain residential services and business services that were the subject of Docket 98-0860. AI contends these services have been incorporated in the Company's annual filing for calendar year 2000, which was submitted to the Commission on April 2, 2001.

The PEPO rejects Staff's proposed one-time rate reduction or credit proposals.

I. Improper Reclassification Penalties

City/GCI propose a new penalty plan to discourage what it viewed as premature competitive classifications. City/GCI propose that on a going forward basis, the alternative regulation plan provide for financial consequences of up to $10,000.00 per day for competitive reclassifications that are later found to be improper by the Commission. City/GCI's proposed penalty would be in addition to any refund requirements applicable pursuant to the PUA. Second, City/GCI propose AI would be required to reclassify improperly classified services back to their noncompetitive status and reduce the rates of those services back to their pre-competitive reclassification level within five days of a Commission Order that rejects a competitive classification. Staff adopted the City/GCI proposal.

AI opposes the improper reclassification penalty proposal. AI argues that nothing in the Act permits the Commission to impose penalties in this situation.

The PEPO rejects the improper reclassification penalty proposal advanced by City/GCI. The Commission's limit of authority is expressed within the Public Utilities Act, specifically the refund provisions of Section 2-202, 13-502 (d) and the enforcement provisions of 13-515. Section 13-515(j) already provides a sanction mechanism, albeit significantly less than that proposed by City/CUB. Further, while this matter was pending, HB 2900 was enacted. The legislature had an opportunity to amend the above referenced statutes or impose additional sanction provisions as propounded by City/GCI and Staff, however it did not.

- **Rate Reinitialization (Part VI).**

Section "A"

The PEPO summarizes the evidence of record for the revenue requirements analysis that the GCI/City presented in support of their reinitialization proposal and the AG/CUB complaint. Staff also performed such an analysis in order to have the Commission informed, but it did not by any means support rate reinitialization.

New section "A" under Part VI, expands the HEPO by including a summary of the record evidence with respect to AI's cost of capital, depreciation, rate base and expenses for the 1999 test year, the parties' positions in these areas, and the rate design proposals that follow therefrom. (Note: In response to the GCI/City's arguments in their 2nd Brief on Exceptions, we have added in the Final PEPO, the different positions taken by the GCI and AI with respect to the effect, if any, of newly amended Section 9-230 on the directory revenue imputation issue. See PEPO at 126). The PEPO draws no conclusions and essentially keeps all these matters in abeyance pending a determination on the underlying issue of rate reinitialization.

(As a general matter, however, we would observe that the analysis of rate of return, capital structure, rate base, depreciation and other expense and revenues assessed in the earnings analyses speak to traditional ROR regulation and, as such muddle the incentives, efficiencies, freedoms and other matters that are an inherent part of, and attendant to, alternative regulation and the move towards competition).

Section "B"

The new law is additional factor to be considered in the determination of the central and overriding issue: whether rate reinitialization is appropriate in these premises.

On the basis of the new legislation and well as other extensive analyses, the PEPO rejects the GCI/City reinitialization proposal that both Staff and AI opposed. (See, new section "B" of Part VI, which, in taking account of the current law, adds an assessment not found in the HEPO).

Note: Only the GCI/City address the Version I PEPO's analysis of this issue. Some minor changes are included in the Final PEPO, based on the arguments set out in the 2nd Brief on Exceptions of the GCI/City.

Further Note:

Although not discussed by any of the parties (or the PEPO), we would observe that aids to determining legislative intent include such factors as the reason for the enactment of a statue, contemporaneous conditions, and existing circumstances. Richter v. Collinsville Township, 423 N.E. 2d 549 (5th Dist. 1981); Chrysler Credit Corporation v. Ross, 328 N.E. 2d 65 (1st Dist. 1975). In the law of statutory interpretation, the doctrine of contemporaneous construction, is based upon the theory that the legislature is familiar with the contemporaneous interpretation of a statute, especially when made by an administrative body or executive officers charged with the duty of administering or enforcing that statute. Thus, it implicitly adopts such interpretation upon reenactment. Sutherland, Statutory Construction, Section 49.09 (5th Edition). When a statute that has received a contemporaneous interpretation is re-enacted, this construction is presumed to be the correct interpretation of the law. Maiter v. Chicago Board of Education, 395 N.E. 2d 1162 (1st Dist. 1979).

One of the circumstances to be noted, is that the HEPO in this matter issued on May 22, 2001 prior to the re-enactment of Section 13-506.1, and the enactment of new statutory provisions directed to carriers operating under a Section 13-506.1 Plan. While the HEPO originated from less than the final authority, i.e., a final Commission Order, it received both press coverage and public discussion at Commission bench sessions such that it is more likely than not, that the General Assembly was aware of it. Furthermore, Section 13-506.1 alternative regulation is not a subject which has generated a multitude of Commission Orders or court decisions. Indeed, there exists only the Commission's Alt Reg Order in Docket 92-0448, the Court's opinion on review in Illinois Bell Telephone Company v. Illinois Commerce Commission, 669 N.E. 2d 919 (2nd Dist. 1996); and the HEPO in Docket 98-0252 et. al, which issued on May 22, 2001. In light of these limited information sources, it is highly likely that the General Assembly would have been aware of and examined the HEPO and the "Heard and Taken" record in this proceeding, when taking action. Accordingly, it could have addressed and altered the interpretations set out therein on the issue of rate reintialization if it so desired. It did not.

- **Service Quality – Going Forward (Part VII).**

Service quality was a highly regarded issue in this docket just as it is in the new law. 220 ILCS 5/13-712. Service quality was also a complicated matter since it involved (i) establishing performance measures; (ii) setting benchmarks for each measure; (iii) building an appropriate incentive structure that would be effective and also co-exist in harmony with the recent legislative action.

Performance Measures/Benchmarks:

The Final PEPO adopts the following performance measures and corresponding benchmarks:

1. Installation within Five Business Days.
   90%

2. Trouble Reports per 100 Access Lines.
   2.66 per 100 access lines.

3. Out of Service Over 24 Hours.
   95%

4. Operator Speed of Answer – Toll, Assistance, and Information.
   5.65 Seconds.

5. Repeat Trouble Rate - Installation
   16.90%.

6. Repeat Trouble Rate- Repair
13.92%.

7. Missed Commitments – Installation.
90%

8. Missed Appointments – Repair.
6.4% misses on field visits.

9. Speed of Answer – Repair Office.
60 seconds.

10. Speed of Answer –Customer Calling Centers
60 seconds.

These measures and benchmarks (essentially the same as those set out in the HEPO), were not disturbed by anything provided for in the new legislation. This does not hold true, however, for the remainder of the issues in this Part of the PEPO.

Measure No. 1

The PEPO (Version I) included a final comment that Staff believes was intended to support the resetting of the benchmark for this measure. (2nd Br of Exception of Staff at 7-8) This is not the case.

It is simply an observation of the fact that, pursuant to Section 13-712, as now in effect per Section 732 of the Commission's rules - customers are being compensated immediately for failures of this service quality standard regardless of the annual benchmark established by the Plan. To make this point clear (as evidently it was not) the Final PEPO includes changes to the language at page 161, to wit:

> It is noted that this performance measure is a service quality standard under the new legislation, i.e., Section 13-712 and adopted in the Part 732 emergency rule such that, regardless of AI's annual performance, credits to customers issue immediately for any service failures.

(The PEPO rejects the other unsupported language changes proposed by Staff for this issue).

Plan Incentive Structure:

-Penalty Amount

At the outset, we believed it appropriate to attach an $8 million penalty for each failure to meet an annual benchmark. (PEPO at 191).

An exception, however, is carved out for the "OOS>24 hrs." performance measure. For this measure alone, a failure to meet the annual benchmark of 90% is being set at $30 million (carried over from the Merger Order). (PEPO at 192).

The PEPO adopts Staff's recommendation to have AI identify any penalty credited to a customer's bill and provide an explanation thereof.

-Escalations

An additional $2 million is being added to the flat penalty amount of $8 million if AI failed to meet the benchmark in any previous year.

So too, if Ameritech would fail to meet a particular benchmark by more than 5%, a $2 million additional penalty would attach. ($10 million). If AI fails to meet the benchmark by 10%, another $2 million would be added. ($12 million). In other words, each 5% increment of failed performance carries an additional $2 million penalty.

With respect to the OOS>24 hours, the Company's failure to reach the benchmark in a previous year would result in an additional $4 million escalation. This means that if AI misses the benchmark in year 2001, the penalty is $ 30 million. If, however, the benchmark is again missed in year 2002, the penalty is increased to $34 million and so on.

(It is well to note that pursuant to the Part 732 emergency rules, customers receive immediate compensation for failures of this service quality standard.)

- The New Law

The new law was a factor to be considered in the development of an appropriate incentive scheme. We took full account of the provisions of Section 13-712, noting that carriers subject to alternative regulations were <u>not</u> excused thereunder. Hence, the requirements put on AI through the statute, and the rules promulgated thereto, had to be harmonized with the Commission's actions under Section 13-506.1.

To be sure, four of the Plan measures adopted in the PEPO, i.e., OSS>24hrs, Installation within 5 days, Repair appointments (premises visits) and Installation appointments (premises visits) are referred to in Section 13-712 (New) as service quality standards to be met by all carriers and the General Assembly has required that customer credits be issued directly for service failures in these instances. 220 ILCS 5/13-712.

The Commission's emergency rules, implementing the provisions of Section 13-712, became effective on August 1, 2001 (or while this matter was still pending). AI along with every other telecommunications carrier is <u>currently</u> obligated to provide customer credits in those situations described under 83 Ill. Adm. Code 732.30. In our view, the credits - required to issue by statute and now by virtue of the Commission's rule - are themselves an “incentive” for the Company to maintain service quality in certain important areas.

Insofar as the 4 performance measures settled in the PEPO are the same as the 4 service quality standards put forth in Section 13-712 (and addressed in our emergency rules); and insofar as the Plan’s incentive scheme in the PEPO amounts to a fine or penalty under Section 13-712 it is appropriate under law and reason to have AI deduct the amount of credits immediately issued to customers from the overall penalty it might incur at year’s end. 220 ILCS 5/13-712. The PEPO sets out this directive.

- Exceptions

In their “second” exceptions arguments, both Staff and the GCI/City continue to call for increased “immediate” compensation in the Plan for OOS>24 hrs. and Installation within 5 day misses, over and above what the Part 732 rule requires for such service quality failures. Our reasons for rejecting their proposal are sound and well analyzed and fully explained.

The PEPO takes great pains to meet with the legislature’s intent in all instances and to harmonize the Section 13-712 “immediate” compensation provisions with the Section 13-506.1 Plan’s “annual benchmark-based” compensation scheme.

Contrary to what Staff and the GCI/City would imply, the PEPO does not state that Section 13-712 precludes the Commission from addressing consumer compensation under its Section 13-506.1 authority. Nothing could be further from the truth. The PEPO only recognizes, as indeed it must, that any additional “immediate” compensation (not based on benchmark performance) should not follow from the Plan but only from the rule authorized by Section 13-712. Otherwise, the Section 13-712 directives would be rendered superfluous in violation of statutory construction doctrine.

The Staff and the GCI/City, however, remain wedded to an assessment that became obsolete when the current law went into effect and would improperly mix “immediate” service quality compensation with “end-of-year” performance compensation. To be sure their proposal was patterned on the scheme outlined in the HEPO at page 139, which itself was premised on an early AI proposal. It was intended to provide some immediacy of relief to customers at a time when none otherwise available. As the PEPO explains, however:

> At an earlier time, prior to the enactment of Section 13-712 (and the adoption of our emergency rules implementing same) we might have been persuaded by Staff’s “immediacy of relief” arguments, and the nature of certain service quality obligations to go outside the benchmark stanard and require AI to give its customers credits (for the most egregious service infractions) at the earliest and without waiting for the end-of-year benchmark figures.

> The “immediacy of relief” ,,,,,,has now been addressed by the General Assembly. (PEPO at 188-189).

The two schemes are essentially as follows:

Sec.13-712 Rule – immediate compensation not tied to any benchmark.
Sec.13-506.1 Plan – compensation follows benchmark failures determined annually.

There is a basic difference to these schemes that Staff and the GCI/City either do not understand or simply choose to ignore. Any arguments, however, that fail to consider or provide analyses in recognition of such differences and the interplay between the schemes, are simply void of merit.

Staff and the GCI/City also fail to comprehend that penalties and compensation in this instance are two sides of the same coin. Simply put, while the $8 million per benchmark failure is indeed a “penalty” in terms of Ameritech, it translates into compensation credits for customers class. (Notably, both the HEPO and the PEPO (Version I) make this point and none of this language is being disputed).

The only argument that the Staff and the GCI/City might have is that the customer credits which result from the Plan incentive are not “immediate.” The credits which followed from the initial phase of the Plan, however, were also not immediate. They attached only to failures of the annual benchmarks. The incentive brought about by Section 13-712 directives and the Part 732 emergency rules, however, does result in immediate and individualized compensation.

Staff and the GCI/City further believe that the “shall take into account” language in Section 13-712 (c) does not require the Commission to offset the statutory service quality compensation against the penalties or fines being provided for under the Plan. (2nd Brief on Exceptions of the Staff at 20). The construction that they offer for this statutory language, however, is both incomplete and unsupported by any recognized authority. In contrast, the PEPO’s interpretation of this provision is in accord with the settled rules of statutory construction, as applied by the Illinois courts, and should be adopted by the Commission. It is well established, that the context in which a term is used, bears on its intended meaning. Christ Hospital and Medical Center v. Illinois Comprehensive Health Insurance Plan, 693 N.E. 2d 1237 (Ist. Dist. 1998).

Note: Staff argues that “take into account” only means to “consider” (although it does not explain to what end). To be sure, in the same part of Section 13-712 (c) at issue, the General Assembly used the term “consider” when outlining factors for service quality rules. It could likewise only have directed the Commission to consider, and not “take into account” credits paid, if such were its intentions. Obviously, it intended something more.

Other Service Quality Issues

In contrast to the HEPO, we now accept Staff's 18-month phase-in proposal for new benchmarks. (See, PEPO, Section E of Part VII at 175-176).

Further, we believe it reasonable to have the provisions of Section 13-712 (e)(6), which define the events and circumstances that excuse the issuance of credits, apply in these premises. (See page 198 of the PEPO). It is noted that the Commission's emergency rules also adopt these provisions. (See, 83 Ill. Adm. Code 732.30 (f)). And, no party objects to this determination.

Finally, the HEPO's analysis and conclusion with respect to the Wholesale Service Quality issue was correct and is being restated in the Final PEPO at 203-204. Lacking a proper record, our attempt to go into the merits in the initial PEPO, turned out to be a flawed exercise. If anything, this solidifies our belief that the HEPO was and is correct in its determination that the instant issue simply does not belong in this docket. It will, and should be, addressed elsewhere.

Remaining Question - The Next Review?

Staff generally recommends that a schedule for the next review of the Plan be specified in the instant Order.

The timing and the particulars of such review, however, have not been proposed by any of parties in the briefs we reviewed nor outlined through any of the testimony.

To be sure, the annual monitoring and reporting requirements, imposed on AI in the 1994 Alt Reg Order, are being retained in full. (See, PEPO at 118). The PEPO also adopts Staff's recommendation that the Commission require AI to maintain adequate records to enable a thorough future review and specifically to:

(1) continue with its filing of monthly service quality standards and benchmark reports;

(2) provide an annual service quality report to all consumers;

(3) notify customers of any rate changes (increases or decreases) brought about through the operation of the Plan.

The PEPO also directs that Staff should not wait to inform AI of any reports it might need or desire for future reviews. (Otherwise the Company could be prejudiced).

As it now stands, however, the PEPO does not provide for a future review of the type that occurred in this proceeding.

This might be a question for the parties to address in oral arguments and based on written comments filed at least 5 days beforehand.

Note – the New Law

Pursuant to Section 13-712 (f), the Commission's rules shall require each telecommunications carrier to provide the Commission, on a quarterly basis and in a form suitable for posting on its website:

> A public report that includes performance data for
> basic local exchange service quality of service.

According to the statute, the performance data shall be disaggregated for each geographic area and each customer class of the State for which the telecommunications carrier internally monitored performance data as of a date 120 days preceding the effective date of this Amendatory Act, i.e., June 30, 2001. The report shall include, at a minimum, performance data on basic local exchange service installations, lines out of service for more than 24 hours, carrier response to customer calls, trouble reports, and missed repair and installation commitments.

EM/PC:jt